145th ANNIVERSARY
THE FIRST NATIONAL CITY BANK OF NEW YORK
1812 - 1957

First National City Bank
Monthly Letter

Business and Economic Conditions

New York, September, 1957

General Business Conditions

THE month of August has rounded out the summer without evidence of decisive change in the business situation. The showing has continued to be mixed, with the over-all trend apparently still sideways at a high level. Despite the absence of any conclusive clue to the trend of fall business – or perhaps because of it – confidence in a vigorous upturn has become more restrained. This shift of sentiment has been accompanied by weakness on the stock exchanges, with the usual effect of casting further suspicion on the business outlook.

So far as over-all figures of production and trade are concerned, the picture is still impressive. Industrial production in August, as measured by the seasonally adjusted Federal Reserve index (1947-49 = 100), appears to have been maintained close to the June-July level of 144, and only slightly below the December 1956 peak of 147. Employment continues at record levels, as a high percentage of workers laid off in industries going slack find jobs in other lines still needing help. In July, unemployment, officially reported at approximately 3 million, was below a year ago. Measured against a labor force of 70 million, this represents substantially full employment, if not over-employment.

Latest seasonally adjusted figures for personal income, retail sales, construction, and aggregate output of goods and services tell the same story of record or near-record performance. Rising wholesale and consumer prices indicate the continued presence of inflationary forces. Whether the sideways movement of recent months represents a prelude to a downturn in business, to a further expansion, or merely to more "rolling adjustment," there is no doubt that, despite soft spots, the country generally is still enjoying exceptional prosperity.

Declining Order Backlogs

All this would be bullish indeed were current high levels of production and employment supported by an equivalent flow of incoming orders to the factories and outgoing shipments. Actually, this does not appear to be the case.

According to Department of Commerce figures, manufacturers – by drawing down order backlogs and building inventories – have, since the beginning of the year, kept output higher than incoming business warranted. In the second quarter, factories shipped out $3 billion more goods than were ordered in that period and produced perhaps half a billion dollars' worth more than they shipped.

This, obviously, is a trend that cannot be continued for long. Unless new orders once more rise to the level of current production and shipments, backlogs of unfilled orders will eventually be depleted and output will be forced down to the level warranted by new business.

Over half the $3 billion decline in unfilled orders during the second quarter occurred in the

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transportation equipment industry group, mainly in orders for aircraft. Because of economy moves, the Defense Department has cut or cancelled certain existing orders and is holding back on some new orders. Further cutbacks in government ordering thus may offset in part any upswing in ordering by private industry during the second half.

Total defense spending is scheduled to drop from the annual rate of $40.2 billion during the first half of calendar 1957 to the rate of $38 billion budgeted for fiscal 1958, according to Defense Secretary Wilson. However, since the cutbacks also involve a shift in emphasis from manned aircraft to guided missiles, the impact on individual firms and localities will be sharper than the over-all 5 per cent reduction would indicate.

Boom Getting Tired?

The current faltering in new ordering is, however, by no means confined to government business. It reflects a general easing in the demand-supply situation all along the line, including sectors heretofore solidly booked for protracted periods ahead.

Signs that the boom may be getting a little tired continue to crop up here and there. Purchases of industrial equipment, recorded as a component of the gross national product figures, dipped slightly during the second quarter, after a steady rise since the first quarter of 1955. Machine tool backlogs have been slipping for some time. Even the market for heavy structural steel shapes and steel plates – until lately one of the tightest of any of the markets for steel products – is now reported to be nearing balance. Demand for nonferrous metals, always regarded as a barometer of industrial buying, has continued sluggish, and copper prices have declined further. In fact, it would be difficult to find many important items for which ample productive capacity does not now exist.

No doubt signs such as these prompted Chairman Martin, of the Federal Reserve Board, to remark to a Congressional committee: "I think savings are increasing rapidly. I am inclined to think we are reaching a leveling out process (in business) and interest rates may stabilize and even decline."

Rising Retail Sales

To a great extent, ordering by private business this fall will reflect retailers' and distributors' appraisal of consumer demand. Retail sales have been rising, on a seasonally adjusted basis, and in July they reached a new record of $16.9 billion, 7 per cent greater than in July 1956. Retailers generally, except for auto dealers, have been holding inventories down so that their stocks are lower not only in relation to sales but also in over-all volume than they were a year ago. So far, nonautomotive retailers appear mildly optimistic rather than enthusiastic over prospects for the fall and Christmas season. There is little doubt that consumers' incomes will be at or near a peak; the question is how much they will be willing to spend and what types of goods will strike their fancy.

As noted earlier, a strong spurt in business ordering is needed to rebuild backlogs and stimulate output. Should orders fail to pick up, further retrenchment of production is indicated, leading almost inevitably to new moves on the part of business to reduce inventories and perhaps to curtail or stretch out capital expenditures.

Hopes Centered on Autos

With private plant and equipment spending leveling off, and federal defense orders being cut back, hopes for a good fall pick-up in business center more and more on the automobile industry.

To be sure, State and local government spending for roads, schools, and other public projects is due to increase steadily. The decline in private homebuilding appears to have bottomed out and may give way to some mild upturn under the stimulus of lower downpayments and the advance from 5 to 5¼ per cent in the allowable interest rate on FHA-insured mortgages. Also, the farm situation has improved over last year.

These factors, of themselves, seem unlikely to exert the needed push to get business off dead center. The automobile industry, however, is bracing itself for a determined attempt to capture consumers' interest. Striking changes are being made in major makes and promotional efforts are being stepped up. Dealers' stocks of new passenger cars have been built up to 805,000 cars on August 31, close to the spring peak and 215,000 more than a year earlier. Much of the buildup has been deliberate in view of somewhat later new model introduction dates for some makes and the highly competitive sales battle expected during the next few months.

Such is the importance of this industry, not only as an employer of labor and a consumer of materials but also as a barometer of the spending mood of the American people, that a successful reception of the 1958 models would undoubtedly have a powerful tonic effect upon the whole economy.

Credit Policy Debated

Senate Finance Committee hearings on "the financial condition of the United States," which began June 18 with Treasury Secretary George M. Humphrey as the first witness, continued in high gear during July and August. After fourteen days of testimony, Mr. Humphrey was followed by Under Secretary W. Randolph Burgess for another ten days. Credit policies of the Federal Reserve came under scrutiny August 13 when Reserve Board Chairman William McChesney Martin began to testify. Meanwhile, the unrelenting pressure of demands for borrowed money led to a further succession of interest rate increases adding more fuel for discussion.

The first major development came in mid-July when the Treasury offered 4 per cent, for one to four years, to holders of $24 billion obligations coming due between August 1 and October 1. As recently as May the Treasury had been able to sell short-dated certificates at 3½ per cent. Questioned by Committee members, Under Secretary Burgess explained that the rate – the highest the Treasury has paid since 1933 – represented an effort to meet the competition for loan funds in a market where other rates had advanced and expectations were current that the Federal Reserve discount rate and bank loan rates would soon be increased.

That the Treasury did not offer an excessive rate is indicated by the fact that holders of more than $1 billion of the maturing obligations preferred to redeem their securities, requiring the Treasury to borrow additional funds for cash. These funds, raised by auctioning discount bills in a congested market, cost the Treasury an average of 4.17 per cent.

In the tightest position at this time of year since the early 1930's, principal commercial banks raised their prime commercial loan rate from 4 to 4½ per cent, mostly effective August 7. During the course of August the Federal Reserve Banks advanced their discount rates from 3 to 3½ per cent. At the hearings, Federal Reserve Board Chairman Martin emphasized that the advances were "merely a recognition of the money rates that had developed in the market."

Selected Money Rates and Bond Yields

	Aug. 29, 1956	Aug. 29, 1957	Change
Discount Rate (F. R. Bank of N. Y.)	3.00%	3.50%	+0.50
Prime Loan Rate	4.00	4.50	+0.50
91-day Treasury Bills, New Issue Rate	2.832	3.497	+0.665
90-day Bankers Acceptances	2.875	3.875	+1.00
90-day Sales Finance Company Notes	3.125	3.625	+0.50
4-6 months Prime Commercial Paper	3.375	4.00	+0.625
Treasury Bonds Due 11/15/61	3.48	3.94	+0.46
Treasury Bonds Due after 25 years	3.21	3.63	+0.42
Bond Buyers Municipal Bond Yield	2.90	3.56	+0.66
Average Yield New Corp. Bonds (Aaa Basis)	4.02	4.78	+0.76
FHA Mortgage Rate	4.50	5.25	+0.75

At the close of August, as the foregoing table shows, money rates and bond yields were ⅜ to 1 per cent above their levels in August 1956, just after the 3 per cent discount rate and 4 per cent prime loan rate were established.

A Fiscal Crisis?

Disturbed by the difficulties of selling government securities, the load of floating debt requiring continuous refinancing, and the higher interest costs, several Senators raised the question whether the Treasury was not facing a fiscal crisis. While Under Secretary Burgess specifically denied the existence of a crisis, Secretary Humphrey frankly admitted that he inherited "a mess" and was passing on "a mess" to his successor, Robert B. Anderson.

The present strain on the U.S. Treasury in meeting its obligations is related in part to failure to hold down Federal Government expenditures and in part to failure to refund floating debt when opportunities were presented.

Although rising revenues have swung the budget into balance, increased expenditures are preventing the development of sizable surpluses for debt reduction and tax relief. Moreover, Treasury debt management during and since the war has added to inflationary pressure. In 1953 and 1955 the Treasury sold $4.3 billion 30 and 40-year bonds but has increased its reliance on Treasury bill finance to an even larger extent. Since 1955 the Treasury has sold no securities which cannot be cashed by the holder within five years. We had on September 1 the incredible total of $127 billion public issues of Treasury securities due within one year or redeemable at the option of the holder.

A Prophecy Fulfilled

This mass of floating debt means that holders of government securities, when money is tight, can embarrass the Treasury with demands for cash and require it to pay higher rates on new borrowings to cover redemptions. If the bulk of the war debt had been funded for a long period of years this problem could have been avoided. And Federal Reserve efforts to restrain money creation and inflation would not have been compromised by concern over the ability of the Treasury to raise funds to pay its bills.

Professor Benjamin Anderson of the University of California wrote prophetically in a symposium, *Financing American Prosperity*, published by the Twentieth Century Fund in 1945:

With respect to the interest burden on the government debt, let me say that this problem becomes progressively worse if we delay it. We can now fund the government debt at moderate rates of interest, as above indicated. If, however, we wait for inflation to come, interest rates will rise rapidly and the Secretary of the Treasury will sweat blood as Treasury bills and certificates fall due, as people cash in their war savings bonds, and as he has to borrow money on the rapidly rising money market — or else print, which would not help the inflation.

This advice was not followed. As noted in the hearings, to soften the blow of the unpegging of the bond market in March 1951, maturities on $15 billion of debt were shortened from twenty-one to five years. Treasury Secretary John W. Snyder late in the Truman Administration made some probing efforts in the 2 to 5-year range, but it was not until eight years after the close of the war, in 1953, that the Eisenhower Administration reopened a market for long-term obligations by a small-scale offering of 3¼ per cent 30-year bonds. Instead of being credited with wise foresight, the Treasury was roundly criticized for paying too much interest. Yet today that 3¼ per cent — and the 3 per cent paid on 40-year bonds in 1955 — look pretty good.

One of the ironic features of the hearings was the fact that some Senators who had criticized the Treasury in 1953 for paying 3¼ per cent complained that the Administration had not accomplished its goal of stretching out public debt maturities. To sell any considerable amount of long-term bonds right now, Under Secretary Burgess testified, would probably require a rate of 4¼ or 4½ per cent.

Senator Kerr suggested that if the whole public debt were converted to a 4 per cent basis the annual interest cost to the Treasury will be raised from the present $7 billion to $11 billion. As Treasury officials pointed out, this is not a realistic assumption. Market rates fluctuate down as well as up. They apply only to securities currently issued to meet maturities; rates on many of the bonds are fixed for years to come. Interest is subject to income tax so that increased interest costs come back in considerable measure. The Federal Reserve System, the largest holder of U.S. securities, is free of regular income taxes but returns 90 per cent of net earnings to the Treasury. The second biggest holder, the Federal Old Age pension fund, is also tax exempt but gets increased rates only after a considerable lag of time.

What to Do?

Nevertheless, it is healthy that the Senate Finance Committee should be concerned with rising interest costs. It will be better yet if the Congress heeds the signal that there are limits on what it can afford to spend. The most direct way to keep federal interest costs down is to reduce expenditures and the public debt. As Senator Jenner exclaimed: "If we cannot reduce debt now, with supposedly great prosperity, when in God's world are we ever going to be able to do it, and how?"

A second way of dealing with interest costs on the public debt is to relieve the steep progression of income tax rates. As Senator Carlson brought out, high interest rates are more apparent than real when tax considerations are taken into account. The high tax rates, sharply cutting the effective costs of money to the borrower and the effective return to the saver, increase demands for borrowed money and restrain the supply.

Federal Reserve Board Chairman Martin, questioned by Committee Chairman Byrd, agreed that the Federal Government was perhaps "the chief offender" in bringing about inflation. Thus the most vital purpose in curtailing public expenditures would be to destroy the widening conviction that the government is going to let the dollar keep wasting away, and restore the confidence of savers in the future value of their money.

The Federal Reserve Bank of Philadelphia had some succinct language on this subject in its August *Business Review*:

Some people earnestly believe that a little inflation — 2% or 3% a year — is a sign of prosperity. But actually, creeping inflation is the pickpocket of prosperity. The school teacher, Government worker, and all other salaried employees take the equivalent of a cut in salary whenever the cost of living rises. Creeping inflation makes suckers out of savers by picking the pockets of those with life insurance, savings accounts, pensions, and annuities.

Create More Money?

Senator Long hinted that interest rates could be reduced by having the Federal Reserve Banks create more money and buy government securities at pegged high prices, as in the 1942-51 period. The question is whether this would work The age-old lesson, as stated by Gerard de Malynes in the seventeenth century, is that "plentie of money maketh generally things deare," and this includes the price of borrowed money.

It is true that the Federal Reserve, under Treasury persuasion, successfully pegged government bonds for those nine years. But people have learned the hard way out of first-hand experience what the consequences are for the value of the dollar. It is doubtful if they could be fooled again. As Chairman Martin stated,

The expectation of inflation would react on the composition of savings. A large part of the savings of the country is mobilized in savings deposits and similar claims that call for some stated amount of dollars. If

people generally come to feel that inflation is inevitable, they will not save in this form unless they are paid a much higher interest premium to compensate them for the depreciation of their saved dollars.

It is for this reason that it is impossible, in a period of demand in excess of savings, to maintain lower interest rates through a policy of "easy credit."

The country is experiencing a period of generally high employment in which investment outlays remain high, but if fears of inflation cause people to spend more of their incomes and save less, the result could only be more rapid inflation and still less saving in relation to income. Such savings as remained, furthermore, would be less and less in the form of loanable funds to finance homes, highways, school construction and other community needs.

Quoting further from the *Business Review*:

If we are simple-minded enough to believe that we can increase our prosperity by increasing the money supply, then why not double our money supply and double our wealth? Better yet, increase the supply of money a hundredfold and make ourselves fabulously wealthy.

We can consume only what we produce, and there is no money magic that will enable us to consume more than we produce.

"Spinning our Wheels"

At the Senate Finance Committee hearings Senator Long spent hours berating Reserve Board Chairman Martin on an alleged lack of progress of the American economy during 1957. He indicated that, with easier access to credit, production and consumption could be higher. "Here is a year," the Senator asserted, "we are just spinning our wheels so far as making any progress."

In support of his case the Senator pointed specifically to the recession below record levels of steel and automobile output and residential construction. But his prime stress was on the published estimates of government statisticians that the income of the American people, after taxes and on a per capita basis, did not rise as much as prices. Disposable income, when computed in 1956 dollars, was reported at $1,705 per capita during the second quarter of 1957 as compared to $1,713 in the second quarter of 1956, a loss of $8 per capita. Therefore, the Senator averred, people should have been provided more borrowed money to spend and raise their consumption levels.

There is an appealing simplicity to this argument. On close analysis, however, it suffers many defects. For one thing the figures cited are published as "preliminary estimates" subject to revisions and corrections. About the time the Senator completed his questioning he got his case strengthened: the 1957 figure was revised downward, to $1,702. The frequency and extent of revisions of national income data has become something of a joke among practicing economists even though it is recognized that the people who do the guesswork are handicapped by inadequate data and are doing their best to approximate the truth.

For the sake of the argument, nevertheless, assume that the figures are exactly right and that the average person lost some fraction of 1 per cent in his real living standard. How could this have happened? For the convenience of the reader the figures involved in the calculation are summarized in the table below:

Changes In Income And Taxes

	Second quarter 1956	1957	Change Dollars	Per cent
Population (millions)	167.8	170.9	—	+1.8
Consumer prices (1956 = 100)	99.4	103.0	—	+3.6
Total (billions, seas. adj. annual rate)				
Personal income	$325.3	$342.4	+17.1	+5.3
Personal taxes	39.5	42.9	+ 3.4	+8.6
Disposable income	285.8	299.5	+13.7	+4.8
Per capita				
Personal income	$1,938	$2,004	+66	+3.4
Personal taxes	235	251	+16	+6.8
Disposable income	1,703	1,753	+50	+2.9
Real per capita (1956 dollars)				
Personal income	$1,950	$1,946	— 4	—0.2
Personal taxes	237	244	+ 7	+3.0
Disposable income	1,713	1,702	—11	—0.6

Working Force Aspects

One point the Senator neglects to note is that $1,700 per capita is a lot of money, beyond parallel in any other nation. It is the achievement of a free enterprise society that naturally oscillates in its forward movement. The planned economy could do better in theory but in practice it bogs down under the weight of bureaucratic overhead. It suffocates the spark of individual enterprising genius.

That per capita income has been so well maintained this year is in some respects remarkable. Not only are workers getting more paid leisure time than ever before; they are supporting more nonworkers. One of the ways people enjoy prosperity, as the record since the depression proves, is by having more children. Growth in population below working age is abnormally great.

At the other end of the population scale, people are living longer but, encouraged by government policy, are retiring earlier. Experienced old hands are being lost to the labor force. Effective last fall the Congress liberalized and broadened the coverage of the Federal Old Age pension system. Since then the number of people collecting such pensions – and giving up rights to take regular jobs in order to qualify – has been rising at an accelerated rate.

Reflecting these influences, the growth of the labor force from the second quarter of 1956 to the second quarter of 1957 barely reached 0.5 per cent against the increase of 1.8 per cent in

total population. It took a real increase in the productivity of the people who were working to make up for the increased number not working.

Thus, one area of "progress" which the Senator does not recognize is the increased leisure provided to people. If production is to be the overriding objective in peace as in war then the liberalization of social security payments, as well as vacation privileges, must be arrested.

Increased Taxes

The figures Senator Long cited were for so-called "disposable income": that is to say, personal incomes after subtraction of personal taxes. The Senator, evidently having in mind federal income tax *rates*, emphasized that taxes had not increased. But, as the citizen is aware, federal as well as State and local taxes have been rising.

It is one of the little tricks that inflation plays that it increases personal income taxes. The reason is the progressive system which imposes higher rates on increases of income. The table reveals this in the oversize increase in personal taxes. Personal taxes were up 9 per cent — more than anything else in the table. They took 20 per cent of the year-to-year increase in personal income and were one of the principal forces depressing per capita disposable income.

So, if Congress is concerned about giving people more disposable income, the most effective approach might be to ease the progression of personal income tax rates. It is not entirely an accident that Congress has been hearing from home, at this juncture, on the tax burden.

It is also worthy of passing comment that, by focussing on personal income *after* taxes, Senator Long implies that the citizen gets nothing of value for the taxes he pays. If government spending and taxation keep rising there may be no opportunity for improvement in the buying power the citizen exercises at his own discretion.

The Foundation for Progress

Senator Long's consumer disposable income analysis takes no specific account, in evaluating "progress", of the record amounts of capital goods that are being put in place this year — the roads and bridges and schools, the telephone and electric lines, the additions to industrial capacity. These things are provided by abstinence from current consumption and will have values to add to the nation's strength in war and well-being in peace for decades and even generations to come. So far as new tools and machines enable the worker to get more done with less effort, they provide the foundation for increased labor productivity and progress.

There is no hope for progress without capital investment and there is no hope for a stable dollar unless capital investment is financed out of saving. As the rising price and interest rate curves show, we have been spending beyond our means, relying on credit too much, and saving too little to finance our long range plans.

Consumers, with enlarged incomes, have spent more but they are not correspondingly better off because prices and taxes have risen. Fiscal and credit policy has failed to hold a balance between saving and investment. Higher living costs restrain consumption to restore the balance. We have been trying to get more out of the economic machine than it can produce without inflation.

Slack for Increased Production

Easy credit makes sense when business and prices are depressed. At the height of a boom it is a ruinous policy.

Ignoring price and credit trends, Senator Long insisted there was slack in the economy. He cited particularly the 80 per cent of capacity operations of the steel industry this past summer, the fact that fewer homes and automobiles are being built this year than in 1955, and the flat course of industrial production in general. But industry is a fraction of business, not the whole. What has happened is that, as Chairman Martin pointed out, consumers have tended to spend somewhat smaller proportions of their incomes on goods and larger proportions in services. Unfortunately, statistics on service lines are fragmentary but there are evidences of record high outlays, for example, on vacation travel.

The official employment statistics show that, while factory employment is running lower, total employment is running higher than a year ago. As Chairman Martin pointed out, little slack is evidenced in the data on unemployment. Wages are still rising, partly because of clauses relating wages to prices, partly because of provisions in labor contracts for periodic increases, partly because of the organized demands of unions, and partly because job opportunities are more numerous, by and large, than job seekers.

All this proves more than anything that we have a highly complex economy which needs some reserves of capacity to meet fluctuating demands. The system might seem simpler if everyone could be told how much of this and how much of that he could have each month. But the precious freedom of the individual as a consumer to choose how he will spend his money demands that, as a producer, he must be prepared to adjust his activity to what is wanted.

A Dubious Course

Senator Long would follow the dictum of Professor Sumner Slichter of Harvard and seek to accelerate production by providing more money and cheaper credit. But if we are already "spinning our wheels" what is the good of pushing down on the accelerator further? If the main result of increased spending has been to raise prices, what is the probability that still more spending would have any other result than raising prices still faster? To be fair with Professor Slichter, he sees no escape from chronically rising prices.

The increase in spending would be made possible by easy credit. Chairman Martin, asserting that we have been experiencing "loose money" rather than "tight money", threw some chilly water on the idea that America's first need is to make it easier for people to get head over heels in debt:

> Borrowing is not the great blessing that some people like to make it out to be. . . . We have tended to glorify debt in recent years all out of proportion to the benefit that it produces.
>
> That is not to say that I do not recognize that debt is important . . . But let us not forget the fact that the greatest slavery in the world is to have people under borrowed money to the point that they are just breaking their backs.
>
> I have watched plenty of them just breaking their backs to meet the payments.

Impact of Inflation

In response to Senator Long's questioning, Chairman Martin commented that the lack of progress in real disposable income may be attributable in some measure to the inflationary spiral. As prices rise people tend not only to spend their money faster but to have their minds diverted from productive accomplishment to means of beating inflation. Bankers can attest to the numbers of people who have inquired dubiously over the past year concerning the prospective value of the dollar.

Meanwhile, the overabundance of employment opportunities has bred a disrespect for the importance of turning in a full day's work for a full day's pay. Being human, people are inclined to relax their efforts if they have things too easy all the time. Organized in trade unions, they enter a mood of willingness to strike to enforce exorbitant pay demands. Employers, enjoying good business and optimistic concerning the prospects of recovering high costs with higher prices, are tempted to grant overgenerous wage settlements that have to be financed by higher prices. And so germinates the wage-price spiral and the insidious idea that money is just going to keep wasting away. As Chairman Martin told the Senate Finance Committee:

> . . . if we let this psychology, which is the factor that has come in the last year and a half that has caused us more concern than anything else — this psychology of the inevitability of inflation — carry us away so that you impair the saving-investment process, then we will not be able to finance the programs that are essential to the country, and we will find a steady erosion of our dollar and ultimately, I think, a change in all of our institutions and the nature of our society. . . .

Mr. Reuther's Generosity

Walter Reuther, president of the United Auto Workers, has been called the "idea man" of U.S. labor. His ideas (e. g., cost-of-living escalator clauses, five-year industry-wide labor contracts, supplemental unemployment benefits) have produced a string of labor "firsts." Unfortunately, they have also saddled the auto industry with heavy wage burdens, pushed up car prices, and added to inflationary pressures in the economy.

Last month Mr. Reuther unveiled his latest idea: General Motors, Ford, and Chrysler should cut the factory price of their 1958 models at least $100 below this year's prices, giving up roughly $600 million in profits (before tax).

The UAW president said this "dramatic and electrifying" step would make a "major contribution toward arresting and reversing the inflationary trend." Henry Ford II, however, called it an empty gesture which "side-steps your primary responsibility for the rising cost-price spiral."

$100 Quid, Zero Quo

Mr. Reuther's plan, on the surface, packs plenty of appeal for millions of prospective car buyers. Who wouldn't like to see reduced prices on the shiny new models for a change? Price tags, however, are not pulled out of the air. They must be related to costs of production.

The UAW chief, in proposing that the auto companies cut profits, did not offer to reduce wages. All he offered was a vague promise to "consider" the impact of the price cuts when presenting 1958 demands for *higher* wage and fringe benefits. Commented Mr. Ford in rejecting the proposal:

> Thus, having poured gasoline on the fires of inflation you now stand by and tell us how to fight the blaze. In return you say you will consider using less gasoline next time — or maybe only kerosene.

Even if Mr. Reuther had said he would hold the line at existing wage levels, there would still be a problem of recent increases in costs. Since 1957 car prices were set, provisions of the existing labor contract have advanced wage rates

(not counting fringes) 14 cents an hour and the cost of most goods and services has gone up appreciably.

Mr. Reuther is willing to be quite generous with other people's money. Of the $600 million savings to consumers about $300 million would be a direct loss of federal income tax revenue, $200 million might be taken away from dividends to stockholders (with a further indirect loss to Uncle Sam), and perhaps $100 million might be subtracted from expenditures for tools and equipment.

How much or little profits Mr. Reuther thinks are right for the auto companies has not been disclosed. There is little question but that new cars have been priced out of the market for many people. But this fact cannot be explained simply by reference to profits. If auto companies had not raised prices, as well as production and sales, to cover the sixfold multiplication of their labor costs over the last twenty years, they would have gone bankrupt long ago.

How to Raise Car Prices

Mr. Reuther's concern over inflation in August is difficult to reconcile with his views in April on 1958 collective bargaining objectives:

> The biggest wage increase in the history of the union. . . . A shorter work-week with increased take-home pay, and more for pensions, more for insurance, hospital and surgical benefits, and more supplementary unemployment pay.

This sort of a program, pressed by a union with power to destroy a major auto producer, does not have much to promise the consumer in the way of lower prices. The biggest wage increase in history (Mr. Reuther did not say he had altered his April objectives) makes the sky the limit. The shorter work week objective — defined by the UAW leader last September in terms of a 4-day week without reduction in pay — begins to look quite pale by comparison. But at least it is specific and provides a basis for computations of cost.

A 4-day week with no loss of weekly take-home pay would mean a 25 per cent increase in hourly wage rates. To maintain previous production — so people could have as many new cars as before — it would be expected of industry to pay time-and-half for the fifth day, resulting in a 37½ per cent increase in average hourly costs.

In 1956 the total wage and salary bill for the "Big Three" auto companies was $5.1 billion. Thus a 37½ per cent wage boost would raise payroll costs $1.9 billion a year, or virtually enough to snuff out all their profits, dividends, and income tax payments. The continued existence of an automobile industry — to say nothing of a balanced federal budget — would hinge on corresponding price increases. But how much?

If the auto workers got away with this kind of settlement it would seem that suppliers, toolmakers, dealers, shareholders, and the Internal Revenue Service would want treatment on the same munificent scale. So the 4-day week would raise the price of a $2,000 car by 37½ per cent or $750.

Monopoly Aspects

This whole episode raises far-reaching questions of monopoly power. Could the Big Three, without violating antitrust laws, get together and cut car prices? And if so, what would happen to the independent auto makers, struggling to keep alive? Could the Big Three, acting in concert, shut down their plants in response to a strike call against any one of their number, instead of letting the UAW labor monopoly pick them off separately?

It is pertinent that each of the Big Three has had years when some people predicted they were done and finished. The best thing about the auto industry from the standpoint of the consumer is the keen competition for his favor among makes and manufacturers.

Thus, the most disturbing circumstance is the aspiration of a labor leader, whose primary aim is to raise wage costs, to intrude upon the job of management. After the profits are all parcelled out, who will be left to run the automobile business except Mr. Reuther?

As L. L. Colbert, president of Chrysler, pointed out in his reply to Mr. Reuther:

> What you are proposing is to abandon one of the basic principles which has enabled the American economy to create ever-increasing satisfactions for the greatest number of people.
>
> You are suggesting that companies — which are responsible for competing successfully and for deciding how much and when to invest in the development of new and improved products, new tools for increased productivity, and long-range programs to meet the needs of a growing population, including the job opportunities needed for the future — should surrender to the UAW their right to make the decisions that are fundamental to carrying out those responsibilities.

Upsurge in Private Investment Abroad

The debate over public assistance to foreign countries, which has occupied an unusual amount of Congressional time this year, obscured a significant new development: private funds are flowing abroad at an unprecedented rate. This up-

surge led Dag Hammarskjold, Secretary General of the United Nations, to comment that the capital outflow in 1956 set a postwar record "due mainly to large increases of capital exports by the U.S., Britain, and West Germany."

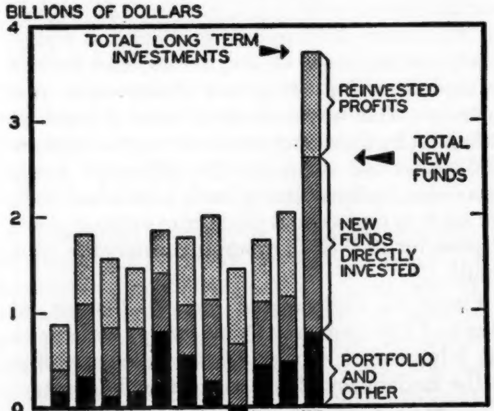
The argument advanced for government loans and grants for economic development is that private capital is not available in adequate amounts. In many cases this is undoubtedly true. Private investments are, however, a good deal larger than is perhaps generally recognized.

According to a U.S. Department of Commerce report released last month, U.S. private long-term investments made abroad last year, including retained earnings, exceeded $3.6 billion, double the $1.8 billion supplied under the economic aid program for the same period. The flow, moreover, is continuing at the same high rate this year.

Even these tabulations fail to tell the whole story. They measure only the *net* flow of private investment – new investments minus proceeds of old investments liquidated and returned to this country. While the net figures may be appropriate for balance of payments analysis, they are not a full measure of the contribution of private capital to economic development. More important, the official figures do not cover such important forms of investment as exploration and development costs charged off, and purchases of equipment equal to depreciation and depletion allowances. As will be shown later, competent students have concluded that capital expenditures abroad by United States investors last year were actually on the order of $5 billion.

Record Capital Outflow

The accompanying chart, based on the official figures only, brings out the upsurge in U.S. private investment abroad to which U.N. Secretary Hammerskjold called attention.



U.S. Private Long-term Investments Abroad, 1946-56

Portfolio investments, until fairly recently held in disfavor by American investors who suffered heavy losses during the 1930's, have been coming back. Last year the flow of such capital amounted to $776 million, bringing the outstanding total at the end of '56 to $8 billion – up some $2½ billion from '46.

Total outflow of new funds, including both portfolio and direct investments, after fluctuating annually around $1 billion during 1946-55, shot up to $2.6 billion last year.

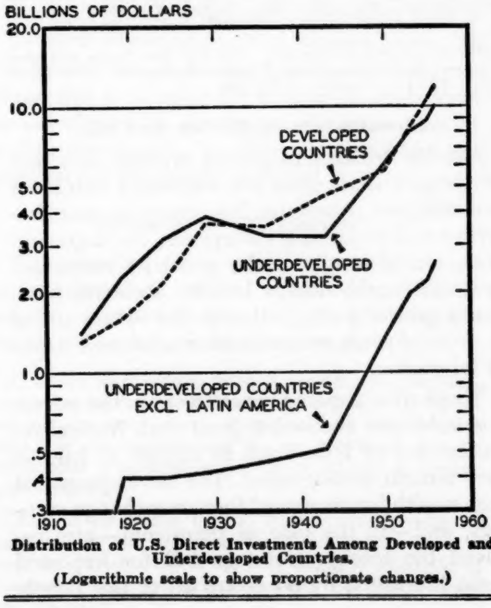
Reinvestment of earnings, another major source of funds, after averaging around $600 million annually in the postwar decade, came to almost $1 billion in '56.

The total direct foreign investment built up from new capital outflow plus reinvested earnings is estimated by the end of 1956 at $22 billion – roughly three times the '46 level. Since these investments are listed at book value – far below their replacement or market value – their economic importance to the host countries is understated.

Complaints About Distribution

Comment is often heard that private investment, though impressive in total, is unduly concentrated in "developed," or industrialized areas with relatively little invested in the less-developed, or semi-industrialized areas, commonly referred to as "underdeveloped."

The fact is that ever since this country emerged as a creditor nation after World War I, direct



Distribution of U.S. Direct Investments Among Developed and Underdeveloped Countries.

(Logarithmic scale to show proportionate changes.)

investments have tended to be fairly evenly divided between developed and underdeveloped countries. This is brought out in the foregoing chart which is based on official figures. For this discussion, the underdeveloped areas include all areas outside the U.S., Western Europe, Canada, Japan, South Africa, Australia, and New Zealand.

Post World War II and Korean War needs for raw materials and petroleum stimulated anew investing in underdeveloped countries, particularly the Middle East. Recently, investment has favored developed countries – attracted especially by the boom in Canada and the widening market for consumer durables in Western Europe.

For the period 1950-56, the increase in direct investments in developed countries of $6.3 billion represented about two thirds of the total gain. However, the $4 billion invested in underdeveloped countries during this period hardly supports the charge that these areas are neglected.

Increase in U.S. Direct Investments in Developed and Underdeveloped Countries, 1950-1956

(Millions of Dollars)

Developed Areas	1950	1956	Increase	Underdeveloped Areas	1950	1956	Increase
Total	5,700	12,070	6,370	Total	6,100	10,048	3,948
Canada	3,579	7,480	3,901	Lat. America	4,735	7,408	2,673
West Europe	1,720	3,493	1,773	Venezuela	993	1,817	824
U. Kingdom	847	1,599	752	Brazil	644	1,209	565
France	217	426	209	Mexico	414	675	261
W. Germany	204	424	220	Peru	145	354	209
Italy	63	204	141	Chile	540	677	137
Netherlands	84	182	98	Cuba	642	774	132
Belgium	65	150	85	Panama*	348	479¶	131
Sweden	58	117	59	Argentina	356	470	114
Spain	31	62	31	Colombia	193	289	96
Australia	201	551	350	Mid. East‡§	670	1,080	410
South Africa	140	289	149	Liberia*	82	338	256
Japan	19	144	125	West Indies†	131	324	193
New Zealand	25	48	23	Philippines	149	266	117
				India	38	109	71

*Reflects shipping registrations. †British West Indies and other European dependencies in the Western Hemisphere. ‡Petroleum only. §Partly estimated. ¶For 1955.

Investments in Mining and Oil

Another criticism of private investment is that too large a share goes into extractive industries – mining and petroleum. Investment in manufacturing and processing enterprises, the argument goes, would result for the countries concerned in wider employment, a broader economic base, and a greater participation in the values added to primary products at the more advanced stages of fabrication.

Those who disparage investment in the extractive industries overlook a great deal. Natural resources are of little value to anyone as long as they remain underground. The development of such wealth has increased foreign exchange earnings, and – in the case of petroleum – also reduced the foreign exchange bill for imported fuels. Moreover, by no means all of this investment is for getting stuff out of the ground. Much of it is for processing and distributing facilities, including construction and maintenance of pipelines, railroads, highways, waterways, and ports serving the country generally. Many companies are operating schools and hospitals that are open to the public.

Besides their own capital outlays, the petroleum and mining companies, along with other private investors, are through tax payments providing governments of host countries with funds which, where constructively used, are of great benefit in promoting economic and social progress. Last year one American company and its affiliates alone paid to foreign governments or collected for them a grand total of more than $1.8 billion in taxes and other required payments.

In Venezuela, for example, some 70 per cent of government revenues in 1956 came from the oil industry alone – with taxes collected from iron ore and other mining ventures accounting for a large share of the balance. As a result of these bonanza receipts, Venezuela is modernizing her agriculture, introducing new industries to use petroleum and natural gas both as raw material and fuel, and launching an extensive highway and railway building program. In barely 20 years Venezuela has emerged at or near the top of the list in Latin America in per capita income and has made tremendous progress in education, health, and sanitation.

Conventional Yardsticks Fall Short

Impressive as these investment figures are, the actual total of private foreign investment, as noted earlier, has been substantially greater than indicated by the official figures.

According to a pioneering study, published in the January issue of the U.S. Commerce Department's *Survey of Current Business*, some 300 U.S. corporations operating in Latin America invested in 1955 nearly $600 million in plant and equipment, net additions to inventories, and outlays to explore and develop new resources or raw materials. This was more than twice as much as indicated by figures on net direct capital outflow and reinvested earnings, the difference being accounted for by utilizing funds which had been set aside to replace and modernize existing plant. Figures for 1950-55 show approximately the same result.

Emilio G. Collado and Jack F. Bennett, of Standard Oil Company (New Jersey), writing in the July issue of *Foreign Affairs*, called attention to the inadequacy of the conventional figures:

. . . The balance-of-payments figure showed a net reduction of $22 million in the Latin American investment

of the entire United States petroleum industry in 1954. Yet in that year alone the Latin American affiliates of our company . . . spent almost $200 million for new plant and equipment and in the search for oil. In this case the spending decisions were not made on one basis for investments with new dollars from the United States and on another basis for those using funds already abroad. In the Jersey company, and probably in most other companies, each new investment project abroad is considered upon the same basis without regard to the source of funds.

The degree to which total private investment abroad has been underestimated is suggested by the 1956 investment figures of the Jersey company. Last year the company would be shown on the net outflow basis as making total investments abroad of only about $289 million. In fact, new investments in property, plant, equipment and in the search for oil amounted to $686 million. . . .

Mr. Collado and Mr. Bennett estimate that gross U.S. private investment abroad in 1956 amounted to almost $5 billion – as against $3.6 billion officially measured by net long-term capital outflow and reinvested earnings. They estimate that $1.8 billion of the gross total – about 35 per cent – went to underdeveloped areas.

Benefits of Private Capital

The Commerce Department's survey provides a case study of the direct and indirect benefits of private investment to the host country. The 300 American firms in the area produced in 1955 nearly $5 billion of goods and services for the local market or export. They earned for Latin America about $1 billion on export account and saved $1.5 billion on import account.

These firms paid nearly $1 billion in salaries and wages to 609,000 employes – only 9,000 of whom were from the U.S. They paid more than $1 billion in taxes, about 15 per cent of all government revenues in the area. They spent more than $1.8 billion for locally-produced materials, supplies, and equipment.

The contribution of private investments cannot be measured in terms of money only. Of immeasurable importance are the initiative, technical aptitudes, and managerial skills that accompany the dollar investment – the "intangibles" that are vital to economic development.

A developing economy is constantly changing and requires adaptation to new situations, resourcefulness, and imagination. Grant aid of public funds spent on the building of modern port installations, for example, will not alone start foreign trade flowing. Needed also are the contributions that can be made most efficiently by private foreign capital and the local entrepreneur – without burdening the U.S. taxpayer.

Promoting Private Investment

Expanding trade and production, growing population, and rising living standards the Free World over are creating new investment opportunities. At the same time realization is growing abroad that U.S. investments are performing an important role in developing resources much faster than these lands could accomplish on their own. The more developed countries have found the capital inflow an important source of dollars to aid in financing their trade deficits with this country. Last year the net outflow of U.S. private capital, both long and short-term, totalling more than $3 billion, constituted next to U.S. merchandise imports the largest source of dollars for foreign countries. In addition, the $1 billion reinvestment of foreign earnings, rather than their transfer to the U.S., relieved the demand for dollars.

A greatly stepped-up flow of capital will depend, however, on the reduction of obstacles. These include inconvertibility of currencies, threat of expropriation or nationalization, political and economic instability, discriminatory local taxation, unreasonable limitation on the use of American personnel, and requirements that local investors have voting control.

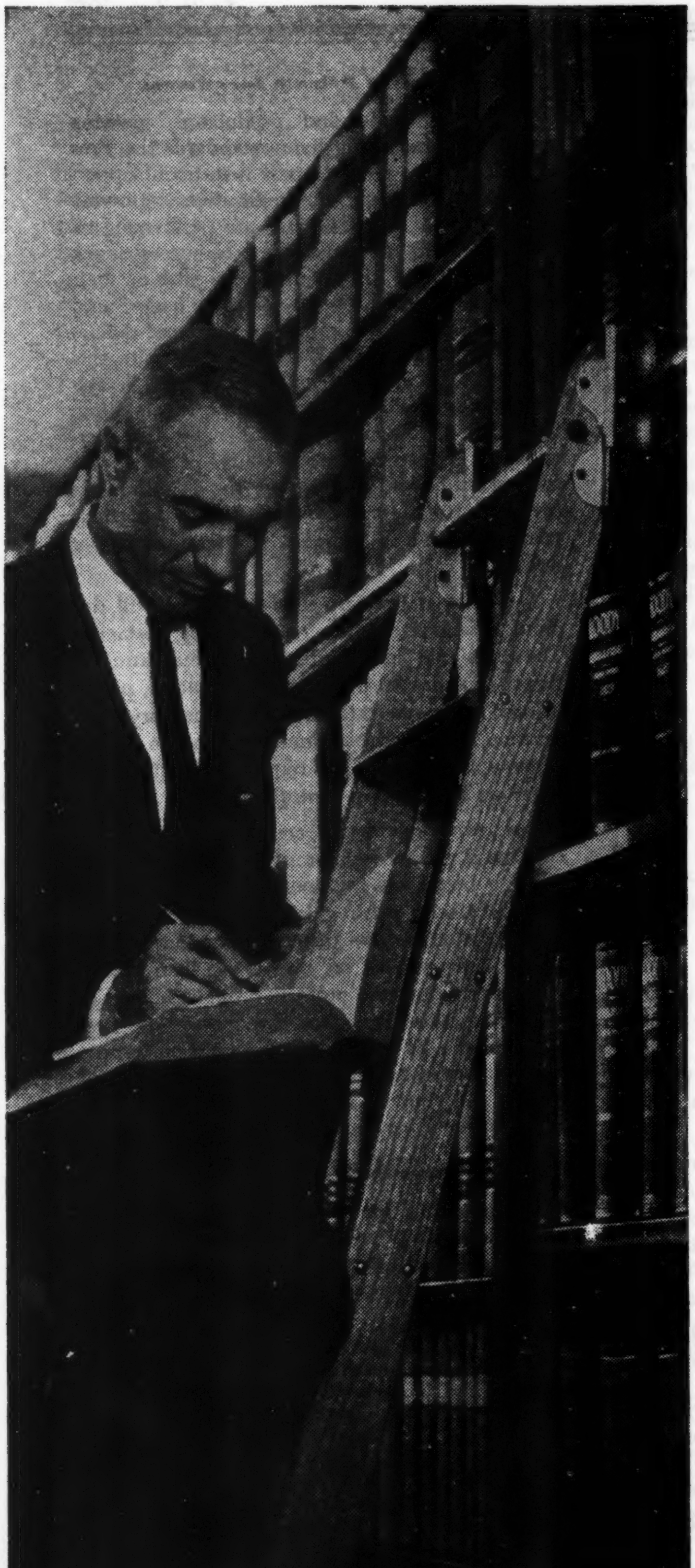
Our own Government could do much to encourage a greater volume of foreign investment through better tax treatment on income earned abroad. Under existing law, any benefit which a corporation obtains through operating abroad in a country with a tax rate lower than ours is eliminated when the profit is brought home. In this connection, President Eisenhower has recommended a 14 point tax differential on income earned abroad to encourage a greater flow of foreign investment. To date, Congress has not acted on the President's proposal.

Investment "Explosion"

The potential for growth in private investments abroad is indeed great. Mr. Collado and Mr. Bennett, in the *Foreign Affairs* article mentioned earlier, summed up the outlook:

If, as we may expect, there is considerable improvement over the next few years in the receptivity to investment in many areas abroad and in the relevant policies of our Government, we are convinced that we will witness a veritable explosion of interest in foreign investment. . . .

There is no reason beyond human remedy why all countries – to the immense benefit of their citizens – could not partake fully of the burgeoning of international investment which we believe possible, and likely, in the next few years.



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